

Letter of Findings Number: 04-20110368
Sales and Use Tax
For Tax Years 2008 and 2009

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ISSUE

I. Sales Tax—Imposition.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-4-1; IC § 6-8.1-5-1; [45 IAC 2.2-1-1](#); [45 IAC 2.2-4-2](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Allied Collection Service v. Ind. Dep't of State Revenue, 899 N.E.2d 69 (Ind. Tax Court 2008); Sales Tax Information Bulletin 2 (November 2011); Sales Tax Information Bulletin 2 (December 2006); Sales Tax Information Bulletin 2 (May 2002).

Taxpayer protests the assessment of additional sales tax.

STATEMENT OF FACTS

Taxpayer is a retailer and service provider of office equipment with operations in Indiana. Taxpayer sells, leases, services and repairs copiers, typewriters, calculators, printers, and fax machines. Taxpayer also provides document management, print management, networking, scanning, and equipment services. The Indiana Department of Revenue ("Department") audited Taxpayer and determined that it had made sales transactions without charging the proper amount of sales tax. As a result, the Department assessed additional sales tax on these transactions. Taxpayer protested the assessment. An administrative hearing was held, and this Letter of Finding results. Additional facts will be supplied as necessary.

I. Sales Tax—Imposition.

DISCUSSION

During the tax years at issue, Taxpayer bought materials exempt, transferred those materials to customers, charged customers one lump sum contract price for "service contracts," and charged its customers sales tax on forty percent of the contract price. The "service contracts" provide for parts and labor for service repairs and also include the transfer of drums, toner, waste bottles, fuser units, and/or staples. Taxpayer was given credit for the sales tax it collected on forty percent of the contract price, and the Department's assessment only imposed sales tax on the remaining sixty percent of the contract price that had not yet been subjected to sales tax.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

An excise tax, known as the state gross retail tax (sales tax), is imposed on retail transactions made in Indiana. IC § 6-2.5-2-1. A taxable retail transaction is "a transaction of a retail merchant that constitutes selling at retail as described in IC § 6-2.5-4." IC § 6-2.5-1-2(a). Selling at retail requires a transfer of tangible personal property. IC § 6-2.5-4-1(b)(2). Since a service does not constitute tangible personal property, the sale of services usually falls outside the scope of the gross retail tax. In "mixed transactions"—i.e., those transactions where tangible personal property is sold in order to complete a service contract, or where services are preformed in order to complete the sale of tangible personal property—it is often difficult to distinguish between the taxable sale of property and the non-taxable sale of services. Allied Collection Service v. Ind. Dep't of State Revenue, 899 N.E.2d 69 (Ind. Tax Court 2008), most recently summarized the parameters of analysis of "mixed transactions" as follows:

[T]he legislature has set forth several parameters for imposing tax on these transactions. First, taxable property does not escape taxation merely because it is transferred in conjunction with the provision of non-taxable services. A.I.C. § 6-2.5-4-1(c)(2). Second, services, generally outside the scope of taxation, are subject to tax to the extent the income represents "any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records." A.I.C. § 6-2.5-4-1(e)(2). Finally, services are also subject to tax if they are provided in the course of a retail unitary transaction, "a unitary transaction that is also a retail transaction." Ind. Code Ann. § 6-2.5-1-2(b) (West 2003). A unitary transaction is a transaction that "includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." Ind. Code Ann. § 6-2.5-1-1(a) (West 2003) (emphasis added).

Id. at 72.

Therefore, there are two instances when an otherwise non-taxable sale of a service is subject to sales tax. The first is when the services are performed with respect to tangible personal property being transferred in a retail transaction and the services take place prior to the transfer of the tangible personal property. IC § 6-2.5-4-1(e). The second is when the services are part of a retail unitary transaction. IC § 6-2.5-1-2. A unitary transaction is defined as a transaction that includes the transfer of tangible personal property and the provision of services for a single charge pursuant to a single agreement or order. IC § 6-2.5-1-1. A retail unitary transaction is a unitary transaction that is also a retail transaction.

[45 IAC 2.2-1-1](#)(a) further explains:

For purposes of the state gross retail tax and use tax, such taxes shall apply and be computed in respect to each retail unitary transaction. A unitary transaction shall include all items of property and/or services for which a total combined charge or selling price is computed for payment irrespective of the fact that services which would not otherwise be taxable are included in the charge or selling price.

Thus, when a retail merchant includes the charge for services and the charge for tangible personal property in one price in respect to a retail transaction, the charge is a unitary transaction and the retail merchant is responsible for collecting sales tax on the entire combined price it bills its customer.

Taxpayer asserts that the Department assessment is contrary to how Taxpayer was treated in a prior audit and, therefore, it deserves prospective treatment. In the alternative, Taxpayer maintains that Taxpayer is not a "retail merchant," but is a "service provider" entitled to an exemption from collecting sales tax on the contract price under [45 IAC 2.2-4-2](#).

As explained in [45 IAC 2.2-4-2](#), "service providers" are granted a narrow exception to collecting sales tax on the entire retail transaction—i.e., contract price if certain conditions are met. [45 IAC 2.2-4-2](#)(a) illustrates the exception, as follows:

(a) Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant unless:

- (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
- (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
- (3) The price charged for tangible personal property is inconsequential (not to exceed 10[percent]) compared with the service charge; and
- (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

Accordingly, a person who obtains and sells tangible personal property that has been combined or altered with services is a "retail merchant" that must collect sales tax on its transactions unless the person meets all four of the requirements of a "service provider" as found in [45 IAC 2.2-4-2](#)(a)(1)-(4). A "service provider" meeting all of the four requirements, does not have to collect sales tax on its sales transactions, and instead is allowed to pay use tax on the "materials consumed [by the taxpayer] as a necessary incident to the service" provided to the customer.

At issue here are "service contracts" that include a maintenance agreement that contemplates not only services, but the transfer of tangible personal property in the form of replacement parts and supplies, such as drums and staples, through the duration of the agreement.

Since May 2002, Sales Tax Information Bulletin 2 (May 2002) has explained the application of the sales and use tax to tangible personal property transferred pursuant to (1) original warranties or dealer warranties, or (2) optional warranties and maintenance agreements and provided this information for "service providers" and an example for "service contracts for office supply companies." (While this language providing information about "service providers" and an example for "service contracts for office supply companies" remained the same an additional paragraph addressing "software maintenance agreements" has since been added in this section which was not relevant to this discussion and has been omitted from the citation provided below by placing [...] where this paragraph is located in the later versions.) The Information Bulletin states, in relevant part, as follows:

Optional warranties and maintenance agreements that also contain provisions for periodic services where tangible personal property will be supplied as a part of the unitary price fall within the ambit of Rule [45 IAC 2.2-4-2](#). This Rule, interpreting [IC 6-2.5-4-1](#), states that where, in conjunction with rendering services, a service provider also transfers tangible personal property for a consideration, this will constitute a retail transaction unless:

1. The service provider is in an occupation that primarily furnishes and sells services, as distinguished from tangible personal property;
2. The tangible personal property is used or consumed as a necessary incident to the service;
3. The price charged for the tangible personal property is inconsequential (not to exceed 10 percent) compared with the service charge; and
4. The service provider pays sales tax or use tax upon the tangible personal property at the time of acquisition.

[IC 6-2.5-2-1](#) imposes the state gross retail tax on retail transactions made in Indiana. If the provisions contained in the warranties or agreements are in complete compliance with all provisions of Rule [45 IAC 2.2-4-2](#), then the periodic transfer of tangible personal property will not constitute a transaction of a retail merchant constituting selling at retail. If such is the case, the service provider is not obligated to collect sales tax on the unitary price of the warranties or maintenance agreements. However, the service provider of the parts or property will be liable for the use tax on the parts or property because the service provider is using the material to fulfill the service called for by the terms of the warranty or maintenance agreement. If the provisions contained in the warranties or agreements are not in complete compliance with all provisions of Rule [45 IAC 2.2-4-2](#), this will constitute a transaction of a retail merchant selling at retail. Thus, the service provider must collect sales tax on the unitary price pursuant to [IC 6-2.5-2-1](#). Any tangible personal property subsequently transferred to the buyer under the terms of the warranty or maintenance agreement is not subject to sales tax.

[...]

Examples:

...

5. . An office supply company sells a photocopy machine to a customer. The customer also purchases an optional maintenance agreement from the company. The maintenance agreement entitles the customer to service and parts at no charge in the event of a breakdown of the photocopying machine. The agreement also provides for quarterly inspections, replacement of the drum after 100,000 copies have been made, and toner to be provided on an as needed basis. The office supply company calculates that the price charged for the above tangible personal property is 35 percent compared with the service charge. The sale of the maintenance agreement is a transaction of a retail merchant selling at retail and is subject to the collection of sales tax.

Sales Tax Information Bulletin 2 (November 2011), 20111228 Ind. Reg. 045110764NRA; Sales Tax Information Bulletin 2 (December 2006), 20100804 Ind. Reg. 045100497NRA; Sales Tax Information Bulletin 2 (May 2002), 25 Ind. Reg. 3595 (Emphasis added).

Taxpayer asserts that pursuant to direction received during a prior audit, it collected sales tax on forty percent of the contract price. However, a review of the prior audit does not reveal this to be the case. The prior audit assessed use tax on Taxpayer's purchase of the materials it used to perform its "service contracts." Presumably, in the years of the prior audit, Taxpayer's contract performance met the ten percent test, and Taxpayer was found to be a "service provider" that owed use tax on its materials and did not have to collect sales tax from its customers on the contract price. Accordingly, for the years at issue, if Taxpayer had paid sales tax or remitted use tax on its purchases of the materials used to perform its "service contracts," Taxpayer would have received credit for the wrongful remittances of tax. However, since Taxpayer did not pay sales tax or remit use tax on its purchases of the materials, Taxpayer has not wrongfully relied on the prior audit.

Instead, Taxpayer charged sales tax to its customers on forty percent of the contract price. For the years at issue, the Department reviewed Taxpayer's records for the "service contracts" and the audit report on page three provides that "in this instance tangible personal property exceeds 10 [percent]" of the contract price. During the protest, Taxpayer provided documentation which compared Taxpayer's total gross receipts to total materials used throughout the year. Taxpayer's spreadsheet on this basis showed that the total materials used through the year were less than ten percent of its gross receipts. However, this is not relevant to whether the materials provided under each contract exceed ten percent of the contract price. In fact, when asked to provide information for specific "service contracts" the supplemental documentation provided showed that the materials provided under a contract exceeded ten percent of the contract price. Since Taxpayer's activities under the "service contracts" fail the ten percent test, Taxpayer does not meet the "service provider" exception from the collection of sales tax and the entire contract price is subject to sales tax. Therefore, Taxpayer has failed to meet its burden of demonstrating that the assessment is incorrect as found under IC § 6-8.1-5-1.

FINDING

Taxpayer's protest is respectfully denied.

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